

# Micro Actions, Macro Results: The Japanese Economic Bubble: A Management View

Matthew M. Amano  
Professor Emeritus of Management  
College of Business  
Oregon State University

## 1. Introduction

Japan experienced a major economic bubble in the latter half of the 1980s. There are two major indicators that tell the magnitude of the bubble. One is land and the other is stock.

The Commercial Land Price Indicator, 100 in 1983, reached 336.8 in 1991. In eight years, on average, the land price had more than tripled. Stock prices also appreciated fast. The Nikkei Dow Jones Average, at the 10,000-yen level in 1984, reached 38,915 yen on the last trading day of 1989. This economic boom was unprecedented in Japanese history. The Japanese welcomed the arrival of the new decade, the 1990s, with great optimism and heightened anticipation for the continued economic expansion.

Yet, the Tokyo stock market fell from the first trading day of 1990. This signaled the end of the grand economic bubble. The market kept going down and hit the bottom in October 1998 at 12,879 yen. This meant, in eight years, the Nikkei Dow Jones Average lost 67% of its market value. The market has recovered since then and is at the 17,000-yen level today (July 2000), or 44% of its peak market value in 1989.

After reaching their peak in 1991, land prices also started to decline. By 1999, the index was at 106.4. On average, those who invested in land in 1991 lost 70% of its value in nine years. In some areas, it is reported, land has lost 90% of its peak values. Land prices are reported to be decreasing even today. Such was the magnitude of the economic fluctuation.

The economic bubble is said to have started in 1985. Five years later, in 1990, it burst. Ten years have passed since then. Japan has not yet succeeded itself in getting out of this major recession.

I wish to share my views with you as to why the bubble occurred and why the economic recession has lasted so long and what are the implications for management.

In short, it appears that the bubble grew because of greed and the recovery is slow because of fear, and it is difficult for management to act against the prevalent social norms.

## 2. A Brief Discussion of the Past

When Japan lost the war against the Allied Forces in August 1945, the country was in ruins. People were hungry, especially in the fall of 1945. For many Japanese, this hard life lasted for five years, until 1950. Many families survived hardship by exchanging their meager possessions, such as clothes, for food. Businesses were the same, using leftover materials to make household wares to satisfy people's immediate needs. Yawata Steel Co., the largest steel manufacturer, made pots and pans with the leftover steel plates to feed their employees and Sony was peddling makeshift electric blankets. The country was in virtual bankruptcy.

The invasion by North Korea of South Korea on June 25, 1950, changed the Japanese economic picture overnight. The U.S. government decided to procure goods in Japan to engage its war efforts in Korea. There was a huge supply of well-educated and willing workers and idled production facilities to respond to the sudden and enormous American demand for business. During the following several years, the Japanese successfully rebuilt Japan from its wartime ruins.

## 3. Growth

By 1960, Japan was ready to start its economic growth. Even at this point, the Japanese economic system was still based on a two-tier system. People in urban areas enjoyed industrial employment with higher wages and benefits. People in rural areas who engaged in farming, fishing, and forestry were working with traditional, labor-intensive methods and earned marginal wages. As economic activities grew in the cities, villages supplied young, well-educated, hard-working workers. In this period, middle school and high school students were

recruited en masse by large companies. Upon graduation, they moved to cities in large numbers.

In the 70s, many industrial companies were running out of their productive capacities. They found it necessary to build more production facilities. Yet, industrial sites in the cities were limited. These companies started securing large tracts of land in rural Japan and began building major factories. Farmland and forests were converted into industrial complexes. For the first time in Japanese history, the rural people began to amass wealth. They were able to mechanize their operations, improve their residential homes, and upgrade their living standards. Young people found many options to employment in their native areas. Wage differentials between rural and urban areas became less pronounced.

#### 4. The Land

As discussed before, when the World War II ended, there were major food shortages. In addition, people needed clothes and other necessities of life. Once these basic needs were satisfied, they started wanting more comfortable shelters.

To build houses, land must be secured. As people became more affluent, the demand for land intensified and, by 1960, land prices had begun to go up. In the 1970s, the rate of increases in land price intensified. For instance, in 1974, the Government reported that land prices had increased 30.9% from the previous year.

People who brought land were rewarded with significant price appreciation. This phenomenon lasted for 40 years, until 1991.

The Japanese land mass is one twenty-fifth of that of America. Yet, its population as well as economic size is about one half of America's. In April 1990, an interesting statistic was published in Japan. The total land value of Japan was estimated at \$2,961 billion. The total land value of America was estimated at \$2,839 billion. At the peak of the bubble, the aggregate value of the Japanese land was more expensive than that of America.

A myth was born. The land price in Japan will only go up, because the land supply is so limited. Even though land prices may occasionally go down for a short time, they will always bounce back. It appears that many people, including politicians, government bureaucrats, business executives, and investors, believed in this MYTH.

#### 5. The Dollar/Yen Exchange Rate

After the World War II, the Dollar/Yen exchange rate was fixed at \$1.00=360 yen. In 1972, however, the exchange

rate moved from fixed to floating system. At first, the dollar value fell only a little at \$1.00=330 yen. Then it moved toward \$1.00=300 yen. By this time, Japan had established herself as a major industrial nation, exporting high quality industrial goods. To Japanese companies, a falling dollar value against the yen meant that their goods were becoming proportionately more expensive in the world market, forcing the Japanese companies to suffer a major competitive disadvantage.

Nevertheless, by the 1980s people enjoyed economic affluence throughout Japan. Their basic needs were fully satisfied. They started seeking not just shelter, but comfortable and quality housing, leisure activities, and travel abroad. High quality condominiums, resort hotels, and country clubs became fashionable.

By 1985, one dollar was worth 240 yen. The U.S. government felt even at this rate, the yen was still too cheap. A meeting of Finance Ministers of five economically advanced nations (G-5: U.S.A., France, England, Germany, and Japan) was held at the Plaza Hotel in New York, in September 1985. The Plaza Accord was concluded by these ministers, where the five nations agreed to cooperate to increase the value of yen against other currencies. This accord had a major impact on the Dollar/Yen exchange rate, as indicated by the following.

July 1986: \$1.00=150 yen  
Feb. 1987: \$1.00=140 yen  
Apr. 1995: \$1.00=80 yen  
July 2000: \$1.00=106 yen

#### 6. Expensive yen

The rapid increases in the yen's value relative to that of the dollar alarmed many Japanese business executives. What they were able to export at \$1.00 in 1972 increased to \$2.57 by 1987. There was a chorus of complaints from the business sectors and the government feared a major economic recession would occur, triggered by the high yen value.

The Bank of Japan, fearing a major recession, lowered the interest rates five times in succession from 5% in 1985 to 2.5% in 1987 in its hope to ease the impact of the yen's high value. This move, however, created a situation where excessive capital became available to finance speculative land ventures.

Meanwhile, demand for land was building up. The Bank of Japan made it easier for speculators to invest in land. Many people consider, in retrospect, that the Bank of Japan's ill-timed interest rate reductions generated

excessive money supply that helped to cause the economic bubble of the 1980s.

In retrospect, these interest rate reductions were not necessary for the following reasons:

1. Demand for Japanese Industrial Products: The reputation of Japanese products had been firmly established by this time and many of the products were being sold with added premiums. Measured price increases would not have made much dent in the demand for the products.
2. TQC Movement: W. Edward Deming was instrumental in introducing statistical quality control concepts and initiating the Quality Control Circle activities in Japan after the war. TQC, first advocated by A. V. Feigenbaum, was also introduced along with many other American management theories and practices. By 1985, the Japanese style TQC was firmly established in many of the Japanese companies, effectively lowering the production costs and helping the Japanese companies become ever more competitive in the world market.
3. Management and Worker Cooperation: The Plaza Accord and the rapid increase in the yen's value against dollar created, for both Japanese management and workers, a sense of business crisis. Employees were willing to participate fully in TQC activities. Management and worker cooperation in TQC made Japanese companies successful in achieving increased product quality, lowered costs, dependable delivery, and customer-oriented services.
4. Lower Costs of Imported Goods: The increase in the yen's value meant lowered costs of imported goods. Japan lacks natural resources. Energy and most raw materials for industrial activities are imported from overseas. When the yen appreciated 300% from the 1970s, it meant that raw material costs decreased by two thirds, all other things being equal.
5. Equity Financing: Banks used to finance large and well-established companies' operations and business expansions. These companies were faithful and trustworthy borrowers of capital from banks. As internationalization of Japanese companies continued, large corporations started securing necessary capital through equity financing in the world market. In 1961, for instance, Sony floated its first ADR (American Depositary Receipt) in America. Sony found it less expensive to finance its business expansions

through equity financing in the world market. Many other corporations followed suit.

## 7. New Borrowers of Capital

By 1985, the Japanese bankers lost major corporations as their main capital borrowers. At the same time, with the rapid lowering of interest rates by the Bank of Japan, the supply of capital flooded the banks. They needed borrowers. Smaller companies, developers in housing, resorts, and recreational facilities, started expanding land-related businesses. At first, they were enormously successful. Major banks started financing these developer-initiated projects on a massive scale.

## 8. The Economic Bubble

Daring enterprises with creative ideas were able to amass fortunes with borrowed money. Bankers felt safe in lending money secured by land as collateral. As the value of land increased, the levels of mortgage limits increased also, making it possible for the entrepreneur to borrow more money from banks. Excessive supply of capital flowed to the stock market, also, causing the Nikkei Dow Jones Average to go up.

For a few years in the second half of the 1980s, banks with so much excess capital to lend encouraged even private citizens to borrow money to invest. Homeowners were advised by bankers to raze their houses and build apartments or condominiums, thus creating a new means of asset building. Those who committed to this new mode of thinking did indeed move into a new, high quality residence, and made a fortune to boot.

Many companies started to secure additional capital from the equity market, not to invest in their production facilities, but to speculate in the booming economy. Speculating in land, stocks, paintings, and other collectible objects often turned out to be more profitable than their main business ventures. Business executives who stayed away from land and stock speculation were often criticized by their employees and journalists as being too timid, ignoring the great opportunity for these companies to amass fortune on the side. Many executives were pressured to speculate in land, stocks, and other "asset building" activities.

Through land and stock investment, it is reported that about fifteen trillion dollars of capital gain was made between 1986 and 1989.

There were voices of caution from prominent and seasoned business executives against such speculation. For instance, Konosuke Matsushita, the founder of

Panasonic, admonished business executives to keep their focus on their businesses, not on land speculation. Masaru Amada, the founder of Amada Machinery, wrote a book titled, "The Victory of Corporate Management with Zero Debt," warned of the danger of speculative ventures through debt financing. These warnings were largely unheeded, however.

The general public started participating in the stock market also. Many IPOs (Initial Public Offerings) were bought up with enthusiasm. The most famous IPO was the case of Nippon Telephone and Telegraph (NTT). In 1989, NTT decided to offer its stock to the public. It was originally considered that a fair market value of NTT would be 700,000 to 800,000 yen per share. Because of the over-heated market condition, it was decided to offer NTT stock at 1.19 million yen per share. The price of its initial trading in the market was 1.6 million yen per share. The stock price soon went up to 2.5 million yen per share.

Land developers, successful with their initial projects, expanded their businesses recklessly. In 1985, there were 1,400 country clubs in Japan. Ten years later, in 1995, there were 2,400 clubs. For a while, constructing a new country club by selling membership seats at inflated membership fees and security deposits was the proverbial golden goose for developers. By the late 1980s, people became used to the idea that "what is bought today will go up tomorrow." An art dealer in Tokyo was said to have confided that he was able to make \$3,000 to \$4,000 by just buying a painting in a gallery in Tokyo and selling the same in another gallery on the same day. Everyone seemed to be looking for moneymaking opportunities. It was becoming more difficult, however, to find good opportunities to make quick gains in Japan.

Near the end of the 1980s those developers who had been successful in speculative land developments in Japan, began their operations in other countries. They started buying landmark hotels, prestigious golf courses, and resort places in America, Hong Kong, Singapore, Saipan, and other places. They even bought the Rockefeller Center in New York.

Until 1984, investment in properties in foreign lands was limited to three or four cases a year. In 1988, forty-eight major investment deals were concluded. The net value of land acquired by Japanese companies in 1984 was 415 billion yen. It was over 13 trillion yen in 1990, or 31 times of the 1984-level acquisition. By 1990, the aggregate land investment by Japanese companies reached 42 trillion yen. Obviously, most of the land was held for speculative purposes and was not employed for productive uses.

Buyers expected that everything they bought would increase in value. They appeared to be greed-driven.

Many major corporate executives, too, were so driven. They lost their sense of corporate missions and proper business conducts. The general public was greed driven, too. They speculated in land, stocks, gold, art, and other objects. It seemed that the entire country was engaged in speculative money making activities.

## 9. Reversal of Interest Rates

By the late 1980s the Japanese government became alarmed by the rampant land speculation, resulting, in part, in the destruction of many healthy communities. The government passed a law severely limiting the bankers' ability to finance land development. At the same time, the Bank of Japan raised the interest rate six times, from 2.5% in 1989 to 6% in 1990.

Quickly funding sources dried up. From 1990 on, land and stock prices fell sharply. As observed earlier, by 1999 the average land price was about one third of what it was in 1990. In certain places, land prices went down as much as 90%. The Nikkei Dow Jones Average recorded 12,879 yen in October 1998, about one third of the 38,915-yen figure recorded on the last trading day of 1989.

With the economic bubble thus ended, many companies went bankrupt and many investors lost their money.

## 10. The Economic Recession

The Tokyo Stock Exchange's Nikkei Dow Jones Average has recovered to the 17,000-yen level this year. Many companies have started hiring new workers from schools and business executives show a greater optimism for the future. The Japanese economy may be finally recovering. But we may have to wait and see. There are many reasons why it is taking so long for Japan to jump-start its economic growth.

1. Extensive Losses: Many companies that engaged in speculative investment in land, stocks, and other commodities incurred massive losses when the bubble burst. Banks that provided easy credit to questionable business projects ended up with billions of dollars of bad debt.
2. Expectations of Quick Economic Recovery and Delayed Fundamental Solutions to Problems: Many company executives who suffered losses thought that the Japanese economy would recover soon. If and when stocks and land prices went back up again, as they always had in the past, their problems would be resolved. Thus, they decided to wait for the economy to recover. Meanwhile, they used many complicated and

often dubious techniques to hide their losses and bad debts.

Unfortunately, the economy did not recover quickly. During the past ten years, bad news has shocked the Japanese people over and over again.

### **11. Cold Reality**

Many companies that made investments in foreign countries, i.e. landmark buildings, resort places, golf courses, and others, at inflated prices, were forced to dispose them at a great loss. It was as if fools sucked up billions of hard-earned dollars from people and threw them away.

One by one, top executives of many major corporations confessed in public of their dubious financial transactions and their consequences. Banks, trading companies, brokerage firms and other respectable business entities that appeared invincible died suddenly and disappeared. This was incredible. Workers who chose these prestigious institutions upon graduating from their colleges did so expecting lifetime employment. However, these companies faded away and workers found themselves unemployed.

There was a myth in Japan that government would save failing financial institutions. Indeed, in the past, banks and brokerage houses in financial troubles were saved by the government. The financial institutions, in turn protected major corporations in financial difficulties. Corporations protected their employees even in economic downturns.

This time, the government did not have the ability to rescue troubled financial institutions. Yamaichi, one of the big four stock brokerage houses, folded its business. So did many major banks.

Suddenly, it became apparent to the business concerns that they were on their own. To survive in economic hardship, they needed to become mean and lean. Companies started restructuring and eliminating middle-aged long-term employees. There was no more lifetime employment.

### **12. Long Lasting Economic Recession**

The Bank of Japan lowered the interest rate seven times, from 6% in 1991 to 1.75% in 1993 to stimulate the economy. They were partially successful and the economy appeared to recover by 1997. However, that year, the government raised the sales tax from 3% to 5%. The general public was already fearful of unemployment

and held the purse strings tightly. This ill-timed sales tax increase made consumers more defensive. For many decades, the Japanese people had enjoyed the economic affluence. Their possessions were overflowing in the household. Consumers, thus, stopped spending.

In order to stimulate consumer spending, the government disbursed 20,000 yen (about \$200) in coupon form to every senior citizen and minor. The only stipulation was to spend the coupon in local stores. This trial ended in failure. People used the coupon to buy necessities and saved their income for rainy days. Consumer spending is not increasing even today.

### **13. Lack of Trust**

Many corruptive, illegal, and self-serving relationships among high-ranking bureaucrats, politicians, and business executives have been reported by the news media. Trust by people in government officials, politicians, and corporate executives has gone down, alienating the general public from the people in traditionally respected offices.

The Japanese people are finding it more difficult to trust even their own employers. Lack of trust breeds fear. Fear encourages conservation of personal resources. Lack of consumer spending is acting as a major deterrent to economic recovery. Each individual's micro activity of not spending is causing the macro result of economic stagnation.

### **14. Conclusion**

I have examined a few aspects of the Japanese economy and offered a number of reasons for the occurrence of a major economic bubble. I also offered a few causes for the economy floundering in its trough.

Now, what would be the implication of this recent economic bubble on management? The most important lesson appears to be that executives must not be overly influenced by pervasive economic optimism on the one hand, and gloom and doom on the other. They need to have their own guiding star, independent of the existing social norms and sentiments. Thus, they can steer their organizations more cautiously at times of pervasive optimism in a robust economy and make bold moves with new ventures when the norm is one of caution and inaction.

It is the top executives' prime responsibility to keep their companies steady in their pursuit of their corporations' original objectives. The recent Japanese experience tells us that many top executives failed to do so. They were

blinded by greed at the height of the economic bubble and now they are frozen into inaction for fear of further failures.

An executive's true character, therefore, is tested at the time of major social and/or economic upheavals like Japan has experienced in recent years.

Note: This paper was initially prepared as a presentation note. It used information from Nikkei Business, Bungei Shunshu, various newspapers, reference books, and government publications.